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Ship Repair industry gets a much deserved GST bonanza

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Introduction:

INDIA has a 7,500 km long coastline. It is located along the Mediterranean trade route that constitutes of approximately 7-9 per cent of the global trade. This shows a great potential for Indian ship repairers to cater to foreign flagship vessels passing by India's coastline.

According to the Ministry of Shipping, out of country's total trade, approximately 70% by value and 95% by volume is handled by seaborne transport. The number of vessels registered under Indian flag have increased from 1135 in 2012 to 1431 as on 01.04.2020. All ships and vessels undergo scheduled and unscheduled repair and maintenance during its entire life time. Ministry of Shipping has laid down various statutory requirements for periodic maintenance, repair and servicing of critical systems on board of ship or vessel. Increased seaborne trade would demand frequent repairs, maintenance and overhaul needs for vessels, which, in turn is sure to boost demand for ship repair industry in India.

India enjoys low labour cost, qualitative work force and adequate availability of skilled professionals to perform ship Maintenance Repair and Overhaul ('MRO') services. This labour intensive nature of ship repair industry puts India to great advantage as compared to advanced nations and also neighbouring countries.

Favourable geographic location, mandatory or recommendatory maintenance requirements, volume of shipping business, availability of skilled and unskilled qualitative labour at relatively lower cost promises great future for Indian ship repair industry. India has a great potential to be global hub for ship maintenance, repair and overhaul services, victualing and also for supply of various equipment, parts and ship stores.

TAX DISADVANTAGE FOR INDIAN SHIP REPAIR INDUSTRY TILL RECENT TIMES:

Till 1st June, 2021, MRO services in respect of ships and vessels were liable to GST at 18% whether provided to Indian or Foreign Shipping Company. MRO services provided to foreign flag vessels were not treated as 'export of services' in spite of receiving consideration in convertible foreign exchange. The MRO services provided to foreign flag ships were treated at par with local services and was attracting GST at 18%.

Exorbitant rate of GST overpowered the labour cost advantage and it made MRO services cost prohibitive when provided on Indian shore. Due to high tax incidence, MRO business moved to neighboring countries like Sri Lanka, UAE, Pakistan and Philippines in GST regime. Apart from foreign shipping companies, even Indian shipping companies sourced MRO services from these neighboring countries. This adversely impacted the Ship repair business in India and also business of ship supplies and victualing. Many MRO service providers have down sized their scale of operations and also the workforce.

Similar position was prevalent in aircraft MRO Industry till March, 2020. However, the Government slashed down the GST rates for aircraft MRO services from 18% to 5% w.e.f. 01.04.2020 vide Notification No. [02/2020 - Central Tax \(Rate\)](#) dated 26.03.2020. The Government also issued Notification No. [02/2020-Integrated Tax](#) dated 26.03.2020 changing place of supply for aircraft MRO services provided to foreign aircrafts from '**place where the services are performed**' to '**location of service recipient**'. This qualified such services as '**export of services**' and consequently spared from GST w.e.f. 01.04.2020.

It was intriguing why above referred benevolent amendments were not done for MRO of ships especially when ship repair industry was a great foreign exchange earner as well as employer to larger number of skilled and unskilled workers. The representations were made to Government to treat ship MRO services and aircraft MRO services at par.

BENEVOLENT AMENDMENTS IN GST FOR SHIP REPAIR INDUSTRY:

Government, acceding to the legitimate request of the industry, has come out with following benevolent notifications bringing cheers to Indian Ship Repair Industry:

- Notification No. [2/2021 - Central Tax \(Rate\)](#) dt. 02.06.2021 - Reducing GST rate to 5% on MRO services in respect of ships or vessels.
- Notification No. [3/2021 - Integrated Tax](#) dt. 02.06.2021 - Changing the place of supply for MRO services provided to foreign flag ships from '**location where services are performed**' to '**location of service recipient**'.

Both these notifications have come into force **w.e.f. 02.06.2021** .

MRO services provided on or after 02.06.2021 will be eligible for these tax benefits.

Notification No. 2/2021 - Central Tax (Rate) dt. 02.06.2021:

The GST rate for ship MRO services are notified at 5% by inserting following entry in the rate notification:

"Maintenance, repair or overhaul services in respect of ships and other vessels, their engines and other components or parts".

As a result, MRO services in respect of ships and vessels provided on or after 02.06.2021 is slashed down from 18% to 5%.

The reduced GST rate is applicable only for ***maintenance, repair and overhaul services*** in respect of:

- Ships or vessels;
- Engine of ships or vessels; and
- Any component or part of ships or vessels or its engines.

Some critical systems, equipment, appliances etc. are integral part of ship or vessel without which ship or vessel cannot ply or not allowed to operate:

- Fire-fighting system and appliances
- Self-contained breathing apparatus, oxygen cylinders, Multi gas detectors, breathing air compressor etc.
- Life-saving appliances like life raft, life boat etc.
- Navigation devices,

- Communication devices,
- Radars,
- Personal locator beacons, etc.

There are regulations laid down by shipping ministry which mandates periodic maintenance and servicing of these systems or components. All these maintenance and servicing activities will now be taxed at concessional rate of 5%.

The reduced GST rate applies only to MRO services and it will not apply to supply of stores, consumables, parts, victualing or services other than MRO services.

MRO services provided to foreign ships or vessels will be treated as export of services subject to prescribed conditions:

Notification No. 3/2021 - Integrated Tax dt. 02-06-2021 notifies place of supply of following services as the **location of service recipient** :

"Supply of maintenance, repair or overhaul service in respect of ships and other vessels, their engines and other components or parts supplied to a person for use in the course or furtherance of business".

MRO services provided on or after 02.06.2021 to foreign flag ships or vessels would qualify as export of service provided the consideration is received in convertible foreign exchange and where such services are provided to ships and vessels used in course or furtherance of business.

Usually, all cargo and passenger ships are used in course or furtherance of business of shipping companies or cruise companies. In such a case, one wonders which ships or vessels are not used in the course or furtherance of business. The warships (belonging to the foreign Government) or private yacht or boats may not be said to be used in the course or furtherance of business and hence MRO services provided to such ships or vessels may not be eligible for tax benefit. Even when the payment for MRO services provided to foreign ships or vessels is received in Indian rupees from local office or agent of shipping company in India, the export benefit will not be available in such case. Such services will be liable to GST at the rate of 5%.

Meaning of MRO services:

As stated earlier, the benefit of reduced tax rate is available only in respect of maintenance, repairs and overhaul services and hence it is important to understand the meaning of these terms.

The term 'maintenance, repair and overhaul' is neither defined under GST law nor in the rate notification. One may have to go by dictionary or common parlance meaning while considering the particular service to be MRO services.

Let's see the dictionary meaning of the terms 'maintenance', 'repairs' and 'overhaul':

a) Maintenance:

Keeping something in good condition (Oxford Dictionary).

Work needed to keep road, building, machine etc. in good condition (Cambridge Dictionary).

The act of keeping property or equipment in good condition (Merriam-Webster).

Maintenance refers to care or upkeep, as of machinery or property, or to the means of upkeep, support, or subsistence (Dictionary.com).

b) Repairs:

To put something old or damaged back into good and working condition (Oxford Dictionary).

To put something damaged, broken, or not working correctly, back into good condition or make it work again (Cambridge Dictionary).

To restore by replacing a part or putting together what is torn or broken (Merriam-Webster).

To restore to good or sound condition after decay or damage (Dictionary.com).

c) Overhauling:

To look at something carefully and change or repair it if necessary (Oxford Dictionary).

To repair or improve something so that every part of it work as it should (Cambridge Dictionary).

To examine thoroughly (Merriam-Webster).

To examine thoroughly and make any needed repairs (thefreedictionary.com).

To make necessary repairs on; restore to serviceable condition (Dictionary.com).

In common parlance, maintenance and overhaul means a preventive care of machinery, equipment, appliance or vehicle etc. to keep them in proper working condition or to enhance the its useful life. The term 'repair' generally means fixing something which is not working or defective and to restore it to working condition. The MRO is an activity physically carried out on equipment, machinery, engine, appliance or vehicle.

The technical consultancy, inspection, testing, surveying etc. require special attention whether such services can be regarded as MRO services and reduced tax rate can be applied to it or not? Sometimes, technical consultancy or inspection is a pre-requisite for carrying out MRO services. In such as case, one may be justified in treating such services as composite supply of ship or vessel MRO services. In case of comprehensive MRO contracts (inclusive of parts, spares, components etc.), entire contract can be regarded as MRO contract eligible for concessional tax treatment.

It is pertinent to note that beneficial tax treatment is given only to ***maintenance, repair and overhaul services*** provided in respect of ships, vessels, its engine and its other components and parts. The provider of ship MRO services will have to closely examine nature of their services and bifurcate it into MRO and non-MRO services.

Any mistake in such bifurcation may result into over or short payment of tax with consequential implications.

SUMMARISED TAX IMPLICATIONS OF MRO SERVICES PROVIDED ON OR AFTER 2 ND JUNE, 2021:

GST implications of MRO services provided on or after 2nd June, 2021 in respect of ships or vessels are summarized as under:

Ship owner / operator	GST implications
Indian entity	GST payable at 5% on value of MRO services.
Foreign entity (Foreign flag ship / vessel)	It will be export of service subject to realization of consideration in convertible foreign exchange. Exporter of Ship MRO service has two options provided u/s 16(3) of Integrated Goods and Services Tax Act ('IGST Act'): 1. Export the services without payment of tax (i.e. tax levied is zero). The exporter following this route can claim refund of unutilized ITC lying in its Electronic credit ledger u/s 54(3) of Central Goods and Services Tax Act, 2017 ('CGST Act').

2. Export such services with payment of tax at 5% and claim refund of such tax u/s 54 of CGST Act r.w. section 16(3)(b) of IGST Act.

This is done by discharging GST liability through electronic credit balance. This is ultimately a method of liquidating the accumulated ITC lying in electronic credit ledger.

The service provider should file letter of undertaking (LUT) in both the above cases and should realize consideration in convertible foreign exchange within prescribed time limit.

The reduced tax rate in respect of MRO services may lead to inverted rate structure i.e. accumulation of input tax credit ('ITC') as most of inputs, capital goods and input services will come with 18% GST as against output tax liability of 5%. MRO service provider is eligible for refund of unutilized ITC u/s 54(3)(ii) of CGST Act subject to prescribed conditions and restrictions.

CONCLUSION:

Favorable tax policies would unleash the potential of Indian ship repair industry and will definitely act as a stimulus for the stressed-out ship repair industry. It would help in furtherance of objectives envisaged in project 'Sagarmala' of Government of India and will have spiral effect of promoting employment, forex earning, foreign investments in ship repair industry and overall economic development of nation.

[The views expressed are strictly personal.]

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